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From Welfare To The Marketplace Managing China's Urban Housing Reform

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Summary

China's urban housing, with chronic shortages complicated by corruption in allocating units, has long been a source of anguish for the leadership. Beijing hopes to alleviate these problems by gradually commercializing urban housing--raising rents, while using economic incentives such as low-cost mortgages to encourage private home sales. We believe Beijing's reforms will ease shortages, although economic constraints and problems with oversight and abuse of the system will render progress slow and painstaking. Indeed, in our view China's reformers are taking a significant political risk with both the public and more conservative leaders by raising expectations of rapid improvements.

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A Financial And Social Headache

Senior Chinese officials recently admitted that poor housing is the number one complaint of urban residents. Surveys underscore the dimensions of problem: average per capita floorspace was just eight square meters in 1986--compared to about 13 square meters in Japan--much of it of substandard quality. Moreover, despite a construction push that has added more than a billion square meters of housing since 1978, the State Commission for Restructuring the Economy estimated in March 1988 that up to a quarter of urban residents live in conditions that are poor even by China's standards. Many city apartment dwellers must squeeze three generations into a couple of rooms and use communal bathrooms that may not even be located on the same floor. These hardships contrast sharply with the boom in construction of relatively luxurious, single-family homes in well-off rural areas surrounding major cities.

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Urban housing is an increasing drain on Beijing's budget. Because nominal monthly rents--about 1 fen (three cents) per square meter--do not cover even maintenance, the bulk of funds for new construction, upkeep, and management come directly from enterprise and government coffers at a cost of over \$8 billion yearly. Indeed, housing has averaged 19 percent of total state investment in new construction over the last seven years, according to official statistics (see table). Urban population growth continues to outpace housing construction, suggesting that correcting the housing problem will only become more costly.

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Table 1
State Investment In Housing Construction, 1981-87

Billion US \$

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	Total Investment	Housing	Share of Total (percent)
1981	11.9	3.0	25
1982	14.9	3.8	25
1983	16.0	3.4	21
1984	20.0	3.6	18
1985	28.9	5.8	20
1986	31.0	4.9	16
1987	35.6	3.2	9

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Beijing--sensitive to worker sentiment--is also increasingly concerned about manager and cadre abuse of housing distribution. Because housing is apportioned by work units (see inset), factory managers and party officials can exert their influence to obtain better housing than their fellow workers. According to press reports, party cadre regularly take advantage of this power to occupy the largest and best-quality homes, and there have been numerous reports of officials custom-building houses, sometimes with illegally obtained money or materials, or securing housing several years in advance for their children. []

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The Enterprise Housing System A Special Challenge To Reform

Control over the construction and allocation of most urban housing in China is widely dispersed among industrial bureaus, cities, and individual enterprises. Before 1978, the state sector invested little in urban housing construction--usually between 4 and 9 percent of its annual capital construction outlay. Since 1979, however, housing construction investment by state-owned units has increased greatly, up to 25 percent of total construction investment in 1981 and 1982. Nonetheless, during the last decade individual enterprises have come to provide the lion's share of total funding--perhaps 60 percent, according to US Embassy sources. Enterprises obtain much of this capital from budgeted social welfare funds and from retained after-tax profits. []

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If an enterprise lacks sufficient land for housing construction, it must apply to higher level units, although press reports indicate that illegal occupation of land for housing construction is common. Enterprises may obtain scarce building materials--many of which are still regulated under the state plan--on the slowly expanding producer goods markets, hoard and divert materials from planned construction, or bargain on the black market with enterprises that have surplus stocks. The largest industrial bureaus and enterprises have their own construction departments, allowing them to build housing with little outside assistance. []

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Municipal and enterprise party officials allocate housing to workers and their families on the basis of workers' personal connections, job performance, political attitude, and family need. The entire process of employee housing allocation is extremely time-consuming. Editors of a major Chinese newspaper recently commented to Westerners that they spend more time on employee housing matters than on any other professional task. []

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Commercializing Housing Step-by-Step

By shifting provision of housing from the state to a commercial industry, Chinese leaders plan to transfer the cost from the government to consumers, while reducing corruption. Housing reform is not new in China,¹ but the program introduced experimentally last year takes a more pragmatic, step-by-step approach. According to a February 1988 State Council housing policy document, China's long-term goal is the emergence of an independent, purchase-based real estate market. Reforms will be implemented over the next five years, with major cities leading off this year and smaller cities and towns following as the housing program solidifies. [REDACTED]

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In the first stage of housing reform, according to the State Council's plan, rents will rise to reflect real costs. The plan calls for new rental rates to factor in depreciation, maintenance, management, interest on investment, and taxes. Initially, rents will increase to at least 27 cents per square meter, and by 1993 are to rise to about 42 cents per square meter. By raising rents and enumerating the components of the increase, we believe Beijing wants not only to cover expenses but also to make renters aware of the real costs of housing. [REDACTED]

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To allay widespread fears that the reform will dramatically raise housing costs for consumers, Beijing is promising that housing subsidies will shelter renters, at least initially, from the financial impact. The February policy announcement bases subsidies on average local per capita living space, rent increases, and wages. Commentary in authoritative press adds that subsidies will range between 18 and 25 percent of workers' pay and, for families with several workers, would exceed rent increases. But workers may use the subsidies only to pay rent increases or to save toward the purchase of new housing. Indeed, enterprises will initially issue the subsidies as coupons good only for housing, though Beijing plans eventually to incorporate them as cash into regular pay. [REDACTED]

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Meanwhile, Beijing is encouraging renters to deposit their subsidy funds in special housing accounts, making them eligible for mortgage loans and thus drawing banks increasingly into housing finance. In April, Li Guixian--new governor of China's central bank--affirmed that China's banks will participate more in financing housing. According to press reports, specialized housing banks have been set up in a few pilot cities. [REDACTED]

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The government hopes that higher rents and the availability of bank loans will encourage workers to buy homes. The State Council document urges enterprises to try to sell new housing before renting it, stating that buyers able to offer at least a

¹ In April 1980, Deng Xiaoping advocated turning housing into a profit-making industry, and later that year the state sanctioned construction of housing for sale to private individuals. In April 1982, the State Council approved a plan under which workers could buy housing for one-third of its construction cost, with work units subsidizing the rest. The idea was widely implemented in 1984 and received an enthusiastic initial response from buyers, but was abandoned in 1985 because it still left too heavy a financial burden to the state. [REDACTED]

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30-percent downpayment will receive preference and favorable mortgages. We believe Beijing also sees housing sales as a prime opportunity to soak up individual savings--up over 800 percent in the last eight years, by official estimates--and redirect spending away from inflation-ridden consumer goods markets. [REDACTED]

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The Obstacles Ahead

We judge that housing reform will be long and arduous. Although press and embassy reporting indicate that the program enjoys wide support in the central government, the fact that its success hinges on implementation at the local level leaves it vulnerable to bureaucratic foot-dragging and manipulation. Moreover, the dearth of administrative guidance suggests that Beijing will be hard-pressed to ensure local implementation. [REDACTED]

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We believe conflicts with other economic priorities may result in slower progress than Beijing envisions. For example, extensive home construction is at odds with the leadership's efforts to clamp down on nonproductive construction that competes with key industrial projects for scarce urban land and construction materials. In our view, economic strains imposed by such conflicting policies will yield at least sporadic slowdowns while Beijing reconciles housing reform with other needs. [REDACTED]

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We also believe China may have trouble reducing the state's role in financing housing. Beijing will have to manage the subsidy program carefully to ensure that it defuses potential unrest over rent hikes without becoming a permanent addition to workers' incomes. We believe Beijing hopes to phase out subsidies quietly as salaries rise and as workers adjust to the real costs of housing. However, without specific guidance on when and how to begin eliminating subsidies, enterprises--wary of worker discontent--will be torn between the temptation to retain subsidies and the need to cut costs and show profits. As a result, we expect enterprises may petition Beijing to continue underwriting their housing expenditures, making reform potentially more costly than the old housing system. [REDACTED]

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Eliminating corruption will be perhaps the thorniest problem Beijing faces in housing reform. The managers and party cadre who profit most from today's system will be loathe to turn housing funds over to banks and see their control of housing allocation dissolve. These officials, who will be in charge of day-to-day implementation of housing reform, are well-situated to delay or water down local programs to fit their own agenda. In addition, they may take advantage of some results of the reform plan to derail it. For example, a recent press article in a PRC-affiliated Hong Kong newspaper criticized profit-seeking housing departments that add excessive taxes and the costs of public utility construction to home prices, suggesting that commercialization could become simply too expensive to work. On the other end of the scale, loopholes such as rent exemptions for the disadvantaged could weaken the program if too many people find ways to exploit them. [REDACTED]

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At the same time, popular expectations will make it difficult for Beijing to shelve the program. Beijing's focus on housing reform is raising workers' hopes, and the help that the initial reforms offer through subsidies and mortgages, supplemented by existing individual savings, makes home ownership financially feasible for at least some. For this reason alone, Beijing's initiatives will probably provide China with more and better housing in the long term. The program, nevertheless, will require close, painstaking monitoring. China's reformers, who have taken an enormous political risk with housing reform, will have to make adjustments to assure progress. [REDACTED]

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